WAWANESA INSURANCE ANNUAL REPORT 2006

SUBSIDIARY COMPANIES

THE WAWANESA LIFE INSURANCE COMPANY

200–191 Broadway
Winnipeg, Manitoba R3C 3P1

100% Owned
Book value of shares $43,939,000

WAWANESA GENERAL INSURANCE COMPANY

9050 Friars Road
San Diego, California 92108

100% Owned
Book value of shares $135,484,000

It is with sadness, and yet with pride, that I submit my last report as President and Chief Executive Officer of Wawanesa. The sadness comes from knowing that I will no longer work directly with so many talented people in our great Company, and the pride comes from knowing that I have done my best in my tenure with the Company to contribute to its ongoing success. I am also honoured to have been asked to continue my association with the Company as a member of the Board of Directors.

I must say that it was somewhat reassuring to have a less eventful year from an operations standpoint in 2006 than the previous few. Automobile insurance receded was an intense focus of consumers, regulators and politicians as rates stabilized or declined, responding to the beneficial effects of tort reforms. Also, the frequency and severity of weather-related events declined to a more normal or expected level.

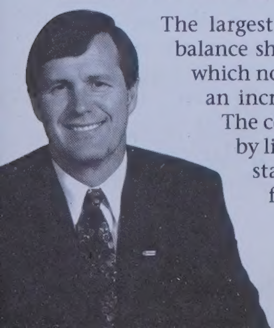
While our growth was still positive, the rate of growth in net written premium and policy count both declined to the lowest level in the past five years. However, our underwriting income and net income were only exceeded by those reported in 2004.

From a profitability standpoint, it is anticipated that the property and casualty industry as a whole will report a good year for 2006. This has been confirmed by the reports released to date by publicly traded property and casualty companies. Earned premiums for the industry will be up about 6%, while claims incurred will have increased only nominally. This will result in improved net income but slightly lower return on equity. Unfortunately, the industry's expense ratio will likely have edged up by more than 2 percentage points to just under 32%.

FINANCIAL HIGHLIGHTS

Reflecting over the past fifteen years, it is gratifying to see results of our combined efforts. Our consolidated assets have grown from $1.13 billion to $4.25 billion and our net written premiums have grown from $521 million to $1.74 billion. Even after acknowledging our significant growth, I still like to think of Wawanesa as "just a little company that happens to write a lot of business". I think our performance confirms that we have continued to meet the needs and expectations of our customers and brokers.

In 2006, the investments on our balance sheet grew by $400 million to $3.4 billion. Due to requirements under the Insurance Companies Act, the vast majority (70%) of our investment portfolio is made up of bonds. During 2006 we brought the management of our entire Canadian bond portfolio in-house under the direction and management of Virginia Mak and her team. This marks a progressive and appropriate step as our Canadian bond portfolio requires more focused attention, with its size justifying in-house management. Equity markets were strong in 2006 and we reaped the benefits of these both in our income statement and in the growth of our unrealized capital gains which now exceed $430 million in our investment portfolio.



The largest item in the liability section of the balance sheet is the provision for unpaid claims, which now stands at $1.52 billion. This includes an increase of about 9% over the prior year. The composition of this is described in detail by line of business in Note 5 to the financial statements and is net of amounts due from reinsurers.

On the Consolidated Statement of Operations and Retained Earnings, our growth in net premiums written and net premiums earned was very modest. Fortunately our claims incurred increased at a lower rate, contributing to an improvement in our loss ratio of more than 2%. Our expense ratio grew to 26.1% from 25.8%. The vast majority of this increase is directly attributed to the investment we continue to make in renewing our enterprise-wide computer initiative called OWASYS. This initiative continues to be a very important project for our Company.

Our combined ratio improved from 98.6% in 2005 to 96.6% this year, producing an underwriting gain of $58 million. This, together with investment income of almost $200 million, and after deducting a provision for income taxes and adding subsidiary income from our Life Company, delivered a net income for the year of $167.1 million. This now brings our retained earnings close to $1.7 billion and reinforces our position as one of the strongest capitalized insurance companies in the property and casualty insurance sector. Our customers and stakeholders can rest assured that their trust is well placed in doing business with Wawanesa.

There are independent organizations in business that rate the financial strength and operating performance of insurance companies. A. M. Best Company is probably the most widely recognized for the property and casualty sector. We at Wawanesa are pleased to report that they have again rated Wawanesa Mutual and Wawanesa General as A+ (Superior). This is a rating of which we can be proud.

REGIONAL RESULTS

We have significant market penetration in all regions from the Atlantic to the Pacific oceans. We respect and appreciate the diversity of each region while at the same time setting standards to gain processing efficiencies. We have nine strong regional offices which have the authority and the responsibility to meet the needs and expectations of their customers and brokers while working within broad policies and procedures of an international company. Each of these regions faces various threats and opportunities at different times and in different ways. Our regional branch staff are our face to the public, and we are proud of the way they represent our Company.

In the Maritime Region we have a very strong market position in New Brunswick and we have been growing steadily in Nova Scotia over the past few years. Our profitability has been good in each of the Maritime Provinces over the past few years.

While profitability continues to be acceptable in the Québec Region, competition in the automobile line of business has been particularly fierce. All property and casualty insurance companies in this region have continued to chase market share and consumers seem to consider automobile insurance more like a commodity than anywhere else in the country. We continue to make adjustments to increase our market share, but we are convinced that our changes will have to come faster and more frequently to sustain and grow our business.

Our regional office in Toronto continues to be our branch with the highest number of policies and premium volume. Needless to say, this branch has received a lot of attention throughout 2006 as we prepare to pilot the new OWASYS system in Ontario beginning in the second quarter of 2007. However, at this time both growth and profitability are lower than desired.

Manitoba and Saskatchewan delivered satisfactory levels of growth in the past year. Their profitability is significantly impacted by the amount of summer storm activity, and given that 2006 was not an exceptional year in that regard, we were satisfied with their underwriting results. Our automobile insurance line for Northwestern Ontario is handled out of our Winnipeg Branch. While the profitability trend in this line of business is improving, we still suffered an underwriting loss for the year.

Alberta is another province that can be impacted by negative summer storm activity but such activity was not significant in 2006. Only two moderately severe storms, one in June and one in August, impacted this province. In both Northern and Southern Alberta our growth was strong and we achieved underwriting profitability in both regions.

In the British Columbia/Yukon region, while our loss ratio inched up, resulting in reduced profitability, our growth was still entirely satisfactory. Over the past few years British Columbia has established a positive growth trend.

Our San Diego operation employs more than 500 people, which is more than any other Wawanesa location. Our growth in business leveled in California and Oregon in 2006. However, the combined profitability of the U.S. branch and Wawanesa General were still satisfactory. It is clear that the San Diego operation has the potential to emerge as our largest operation in the foreseeable future, when assessed by premiums written, and even policy count. We look forward to our continued success in the United States.

LIFE COMPANY

Wawanesa Life had another solid year in 2006 with positive results in several areas of the Company. This is quite an achievement when compared to the record 2005 pre-tax and after-tax income levels, and to the record sales achieved by the Company as a whole in 2004. The bar was certainly set high at the start of the year and many measurable successes were achieved.

Overall premium income grew to $80.7 million, an increase of $2.5 million over 2005. Total assets under administration, including segregated funds, increased by $50.7 million to $575.8 million. Pre-tax income was $8.3 million and after-tax income was $5.8 million. This is a very respectable result in comparison to the 2005 record income of $10.6 million pre-tax and $7.1 million after tax.

Our Individual Operation continues to be a growing success. Life insurance sales showed strong growth, with annualized premium income of $4.2 million; 12.5% higher than 2005. This is a new record. This recent history of strong sales growth and favourable in-force persistency has resulted in a steady increase in our premium base which now stands at $31.0 million, an increase of 6.3% over last year. Our individual savings products are selling at consistent levels year over year, while the policy values have shown strong growth of 9.2% to reach $262.9 million by year's end.

Certainly some of the success for the Individual Operation in 2006 is due to the actions taken in 2005. Design enhancements and pricing changes were made to many of our plans during the course of 2005, concluding with a significant premium reduction in our Renewable Term plans in December 2005 that put the Life Company in a very competitive position in the marketplace. Maintaining this competitive position was our focus in 2006. As an added service to our distribution partners, we moved our weekly compensation cycle to a daily cycle. This was an important initiative as very few companies provide this kind of service.

The Group Operation has successfully held its own in 2006 under extreme competitive pressure, while successfully implementing a new back office administration and claims system by year's end called Eclipse. Premium income was $23.9 million which is consistent with 2005. However, the favourable claims experience that the Group Operation had seen for the past three years, especially in the disability area, did not hold out. The result was a small loss for the year. New business sales were disappointing at $1.7 million, down 12.5% from 2005.

Certainly the Group Operation's ability to retain policyholders and attract new ones has been hindered by the lack of an on-line or web-based technology that is now common in the marketplace. The launch of the Eclipse back office system was the first crucial step in this direction. It involved countless hours of work from Information Services and from the functional departments. This speaks highly of the commitment and dedication of everyone working directly on the project as well as those maintaining normal operational workloads. I'm confident that this level of commitment will continue as we work to bring our on-line technology to market in 2007.

Building on this business requirement, the Sales and Marketing Department is taking steps to enhance our business development plans and to focus on increasing awareness of Wawanesa Life as a group insurance player. These steps are key to positioning us for premium and market share growth in the future.

While Wawanesa Life is investing in improving its systems, it is also investing in its people. In June, 2006 Wawanesa Life was awarded the LOMA's Excellence in Education award for the 7th time. This is quite an achievement because of the 1,200 LOMA member companies, only 63 were given this award in 2006.

Wawanesa Life continued its track record of financial strength in 2006. The MCCSR (Minimum Continuing Capital and Surplus Requirements) ratio is now 270.5%, well above industry standards and significantly above the minimum requirements set by the Office of the Superintendent of Financial Institutions. In addition, Wawanesa Life continues to be rated as A (Excellent) by A. M. Best.

LOOKING FORWARD

It is obvious we are firmly positioned in the "soft market" portion of the insurance cycle. Customers are enjoying reduced or stable premium levels, while insurance companies jockey for market position. Demand for lower auto rates will soon meet the reality of claims inflation. We must prepare the public for modest rate increases. Suppressing rates too long can inevitably lead to the need for greater longer-term increases. As an industry, we have learned and should not forget the lesson, that if rates increase too severely at one time, consumers will become frustrated and we will have eroded the confidence that we are trying to earn back.

We also cannot abandon our continuous communication and collaboration with regulators and politicians. The Insurance Bureau of Canada and the Insurance Brokers Associations across the country are important organizations that can convey our messages effectively. Governments who intervene

too heavily into rate regulation will ultimately contribute to ineffective markets. If rates are artificially suppressed or underwriting regulations are made too severe, it will ultimately lead to the exit of some insurance companies. This results in reduced consumer choice and eventually higher premiums. Rate regulation can also lead to bloated residual markets whose experience must be spread over the broader population. This results in the subsidization of poorer risks by better risks. Evidence is plentiful, showing that rigid regulation of auto insurance rates and underwriting criteria does not ultimately benefit consumers. The best protection can be to allow market forces to act in achieving affordable and available insurance.

There is another ongoing important consideration for the future. If insurance companies and their broker partners always focus on the best interests of their customers, business will flourish. This seems like a trite refrain, but it can never be repeated often enough. At Wawanesa, we have understood and practiced this for over 110 years, and we will remain focused on serving the best interests of our customers.

Brokers also must remember that the greatest advantages they have are the professional advice they offer and the choices they provide to the consumer. They must guard their independence scrupulously to avoid actual or perceived conflicts of interest. The products we sell can be complex, and more disclosure and transparency can only assist the customer in understanding what they are buying.

I predict that recruiting the best talent to our industry will become increasingly difficult if we do not make it a focus of our attention. Few young people start out their careers with the intention of becoming an insurance professional. Most people I have spoken to entered the insurance business by happenstance before realizing it could provide them with a rewarding and successful career path. The level of education and professionalism has increased tremendously in our industry over the past two decades and I hope it continues. With the demographic changes and the competition for talent, attracting and retaining the best and the brightest must be a priority.

Speaking of priorities, at Wawanesa our number one priority these days is technology enhancement. In 2006 we invested significantly in people, application development and equipment. I see this continuing well into the foreseeable future. Technology touches everything in our business. It facilitates our communication, it enhances our customer service, it helps fine-tune our pricing, it streamlines our distribution, and it can improve our overall efficiency.

While change can be exciting, it can also be frustrating and unnerving. At Wawanesa we are committed to change for the betterment of our value proposition and for the benefit of our customers, employees and other stakeholders. While our OWASYS project is not advancing as fast as we would have liked, we are committed to driving it forward to a successful conclusion.

ACKNOWLEDGEMENTS

Early in the year, Paul Thorimbert, our Vice President, Information Services, retired after 36 years with the Company. We thank Paul for the contribution he made as data processing evolved from a function on the periphery of our business to an integral part of our entire operation. We are fortunate indeed to have recruited Cam Loeppky to succeed Paul. Cam has the talent and the experience to lead us to the next level in the world of Information Services.

Dave McFarlane joined our Company just two years ago as Vice President and Chief Operating Officer of Wawanesa Life. He fit in well and had only begun to make his mark when personal issues caused him to rethink his future and step into early retirement. We thank Dave for the contribution he made in the short time he was with Wawanesa. Fortunately, our own Mary Nemeth was ready, willing and able to succeed Dave and has accepted the challenge to lead our Life Company. She has a record of ambition, success and accomplishment which will serve her well in her new role.

In 2006 I also announced my intention to retire as President and Chief Executive Officer in May, 2007. This was not a surprise for our Board of Directors as we had followed a textbook process of succession planning, beginning in 2001. This process led the Board to select and announce Mr. Ken McCrea as my successor. Ken is an excellent choice, with some new ideas of how to move Wawanesa forward while maintaining the formula that has helped it succeed in the past. I offer Ken my very best wishes and I trust that you will give him the support you have always afforded to me.

2006 also marked the end of an era as John Bulman retired as the Chairman of our Board of Directors. John was associated with our Company for over 35 years and took great pride in the progress he witnessed and the contribution he made to our great Company. Thank you, John.

Barry Harrison has been on our Board of Directors since 1994 and the Board has demonstrated their confidence in his leadership by selecting him as Chairman. Barry has a broad base of directorship experience, complemented with good judgment that will serve our Company well.

As I prepare for my retirement in May, I thank you all for the many wonderful memories. I consider myself so fortunate to have found Wawanesa and to have crossed paths with so many capable people. I'll always cherish my years of working with you. I thank my fellow employees, both present and past, many whom have become my friends. I thank the Board of Directors, both present and past, for their counsel, thoughtful debate and support, always focused on the success of our Company. I thank our brokers for helping us to become a better company and for offering thoughts and ideas on how to get there. Finally, all of our suppliers, business partners and reinsurers…I thank you for helping us serve the customers of Wawanesa in the best way possible.

Gregg J. Hanson, FCA, FCIP, FLMI

President and Chief Executive Officer

AUDITORS' REPORT

Founded in 1896
Incorporated May 1, 1929

Head Office
Wawanesa, Manitoba

Executive Office
900 – 191 Broadway
Winnipeg, Manitoba

OFFICERS AND CORPORATE MANAGEMENT

G. J. Hanson, FCA, FCIP, FLMI
President and Chief Executive Officer

G. N. Bass, Q.C.
Vice President, General Counsel and Secretary

B. A. MacKinnon, FCAS, FCIA, MAAA
Vice President and Chief Actuary

K. E. McCrea, CA, FLMI
Vice President and Chief Financial Officer

M. J. Bjornson, FCIP, FLMI
Vice President, Marketing and Property Underwriting

P. R. Goodman, CA
Vice President and Comptroller

S. J. Goy, ACAS
Vice President, Automobile Underwriting

R. G. LaPage, FCIP, CRM
Vice President, Claims

C. R. Loeppky, BScCs
Vice President, Information Services

C. B. Luby, FCIP, CRM
Vice President, Branch Operations

T. L. Nelson, FLMI/M, CHRP
Vice President, Human Resources

P. R. Mulaire, CMA, FCIP, CIA
Manager, Internal Audit

To the Policyholders of The Wawanesa Mutual Insurance Company

We have audited the consolidated balance sheet of **The Wawanesa Mutual Insurance Company** as at December 31, 2006 and the consolidated statements of operations and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

Note 2 describes the policy with respect to the non-consolidation of a 100% owned subsidiary, The Wawanesa Life Insurance Company, whereby the investment is recorded on the equity basis. In this respect, the consolidated financial statements are not in accordance with Canadian generally accepted accounting principles. Note 4 includes information on significant balance sheet and income statement items of the subsidiary. Had the financial statements of the subsidiary been consolidated, virtually every account in, and the information provided by way of notes to, the accompanying consolidated financial statements would have been affected by the underlying information of the subsidiary.

In our opinion, except for the effect of not consolidating The Wawanesa Life Insurance Company, as described in the preceding paragraph, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
February 19, 2007, Winnipeg, Manitoba

PRICEWATERHOUSECOOPERS

To the Policyholders of The Wawanesa Mutual Insurance Company

I have valued the policy liabilities of the Company for its consolidated balance sheet as at December 31, 2006 and their change in the consolidated statement of operations and retained earnings for the year then ended in accordance with accepted actuarial practice including selection of appropriate assumptions and methods.

In my opinion the amount of policy liabilities makes appropriate provision for all policyholder obligations, and the consolidated financial statements fairly present the result of the valuation.

Brett A. MacKinnon

Brett A. MacKinnon, FCAS, FCIA, MAAA
February 19, 2007, Winnipeg, Manitoba

BRANCH OFFICES

Maritime
1010 St. George Boulevard
Moncton, New Brunswick
S.M. Gates, CHRP
Vice President, Maritime Region

Québec
8585 Décarie Boulevard
Montréal, Québec
C. Auclair, PAA
Vice President, Québec Region

Ontario
100–4110 Yonge Street
Toronto, Ontario
T. R. Greer
Vice President, Ontario Region

Winnipeg
700–200 Main Street
Winnipeg, Manitoba
E. Rossong, FCIP
Vice President, Winnipeg Region

Prairie
Wawanesa, Manitoba
W. G. McGregor, FCIP
Vice President, Prairie Region

Northern Alberta
100, 8657–51st Avenue
Edmonton, Alberta
N. D. Miller, FCIP
Vice President, Northern Alberta Region

Southern Alberta
600, 708–11 Avenue S.W.
Calgary, Alberta
J. A. Breau
Vice President, Southern Alberta Region

British Columbia
400–1985 West Broadway
Vancouver, British Columbia
K. L. Coates, FCIP, FRM
Vice President, British Columbia Region

United States
9050 Friars Road
San Diego, California
D.J. Goss
Vice President, United States Operations

CONSOLIDATED BALANCE SHEET

	As at December 31	
	2006	2005
	('000s)	
ASSETS		
Investments (note 3)	$ 3,410,774	$ 3,010,503
Cash and short-term deposits	-	84,755
Accrued investment income	23,655	19,879
Receivables	415,805	409,542
Investment in subsidiary (note 4)	43,939	41,509
Real estate—at cost, less accumulated depreciation of $26,411 (2005 – $24,597)	46,770	47,795
Furniture and equipment—at cost, less accumulated depreciation	12,851	12,242
Due from Facility Association	21,651	17,317
Deferred acquisition expenses	135,455	124,850
Future income taxes (note 7)	142,186	108,825
	$ 4,253,086	$ 3,877,217

LIABILITIES		
Bank indebtedness	$ 26,821	$ -
Unpaid claims (note 5)	1,520,948	1,394,637
Income taxes payable	13,133	15,421
Other liabilities	111,826	102,310
Unearned premiums	878,490	829,482
Mortgage payable (note 8)	13,188	13,363
Total liabilities	2,564,406	2,355,213
Retained earnings	1,688,680	1,522,004
	$ 4,253,086	$ 3,877,217

The accompanying notes constitute an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF OPERATIONS AND RETAINED EARNINGS

	For the year ended December 31			
	2006		2005	
	('000s)			
Net premiums written		$ 1,739,532		$ 1,700,517
Increase in unearned premiums		(48,425)		(60,845)
Net premiums earned		1,691,107		1,639,672
Instalment service charges earned		22,963		21,433
		1,714,070		1,661,105
Deduct: Claims incurred	$ 1,215,334		$ 1,214,998	
Expenses incurred	440,664	1,655,998	422,872	1,637,870
Underwriting gain		58,072		23,235
Investment income (note 3)		199,729		194,765
Income before income taxes		257,801		218,000
Income taxes (note 7)				
Current	126,172		105,922	
Future	(33,041)	93,131	(30,743)	75,179
Income before the following		164,670		142,821
Income from subsidiary		2,430		4,796
Net income for the year		167,100		147,617
Retained earnings—Beginning of year		1,522,004		1,381,402
		1,689,104		1,529,019
Foreign currency translation adjustment—net of income taxes of $776; (2005 – $(3,410))		(424)		(7,015)
Retained earnings—End of year		$ 1,688,680		$ 1,522,004

The accompanying notes constitute an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

	For the year ended December 31	
	2006	2005
CASH PROVIDED BY (USED IN)		
Operating activities		
Receipts		
Premiums received	$ 1,718,895	$ 1,672,817
Investment income received	167,541	151,295
	1,886,436	1,824,112
Payments		
Claims paid	1,060,331	1,050,496
Expenses paid	436,313	406,868
Income taxes paid	128,459	150,172
Change in other assets and liabilities	21,913	(63,188)
	1,647,016	1,544,348
Net cash from operating activities	239,420	279,764
Investing activities		
Bonds purchased	(5,238,178)	(5,403,324)
Bonds sold, redeemed or matured	5,044,734	5,143,036
Shares purchased	(408,197)	(228,318)
Shares sold or redeemed	255,374	201,261
Furniture and equipment, net	(4,931)	(5,060)
Real estate purchased	(809)	(329)
Other assets, net	1,784	(174)
Foreign exchange	(773)	9,530
Net cash used in investing activities	(350,996)	(283,378)
Decrease in cash for the year	(111,576)	(3,614)
Cash and short-term deposits—Beginning of year	84,755	88,369
Cash and short-term deposits (bank indebtedness) —End of year	$ (26,821)	$ 84,755

The accompanying notes constitute an integral part of the consolidated financial statements.

1 REPORTING RESPONSIBILITIES

The financial statements and accompanying notes are the responsibility of management.

The external auditors of the Company are required to conduct an examination in accordance with Canadian generally accepted auditing standards to enable their reporting to the policyholders as to whether the annual financial statements present fairly, in all material respects, the financial position and results of operations of the Company in accordance with Canadian generally accepted accounting principles.

The Actuary is appointed by the Board of Directors pursuant to the Insurance Companies Act. He is responsible for ensuring that the assumptions and methods used in the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation and associated regulations or directives. He is also required to provide an opinion regarding the appropriateness of the policy liabilities at the balance sheet date to meet all policyholder obligations of the Company. Examination of supporting data for accuracy and completeness and analysis of Company assets for their ability to support the amount of policy liabilities are important elements of the work required to form this opinion.

Policy liabilities primarily include unearned premiums, unpaid claims and adjustment expenses, the reinsurers' share of unearned premiums and unpaid claims and adjustment expenses and deferred premium acquisition costs. The Appointed Actuary uses the work of the external and internal auditors in verifying data files for valuation purposes.

2 SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with the Insurance Companies Act which states that, except as otherwise specified by the Superintendent of Financial Institutions Canada ("the Superintendent"), the financial statements are to be prepared in accordance with Canadian generally accepted accounting principles. The significant accounting policies used in the preparation of these financial statements are summarized below. These accounting policies conform, in all material respects, to Canadian generally accepted accounting principles except that one subsidiary is not consolidated, as explained below.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenue and expenses during the periods covered by the financial statements. The principal financial statement components subject to measurement uncertainty include the provision for write-down on investments (note 3), the provision for unpaid claims (note 5) and the carrying value of future tax assets (note 7). Actual results could differ from those estimates.

Basis of consolidation

These financial statements include consolidation of the wholly-owned subsidiary, Wawanesa General Insurance Company. The wholly-owned subsidiary, The Wawanesa Life Insurance Company, is not consolidated because management of the Company has determined that reporting of property and casualty and life insurance operations on a consolidated basis would not provide meaningful presentation. The Wawanesa Life Insurance Company is accounted for by the equity method. Its income is reflected in operations and the cost of the investment is adjusted to include post-acquisition income and is reduced by dividends to the parent.

Premiums earned

Premiums are taken into income on a pro-rata basis over the policy term.

Acquisition expenses

Commissions and premium taxes are deferred to the extent that they are considered recoverable and are expensed in the accounting periods in which related premiums are recognized as income. The ultimate recoverability of acquisition expenses is determined without regard to investment income.

Investments

Bonds are carried at amortized cost providing for the amortization of the discount or premium on an equal yield basis over the period to maturity. Preferred and common stocks are carried at cost. Real estate is carried at cost. When, in the opinion of management, there has been a loss in value of an investment that is other than temporary, the investment is written down to its estimated realizable value. Such write-downs are reflected in the provision for write-down of investments. Estimated realizable values of bonds, preferred and common stocks are primarily based on quoted market values.

Investment income is recorded as it accrues. Dividend income on common and preferred shares is recorded on the ex-dividend date. Gains and losses are determined and recorded as at the trade date, and are calculated on the basis of average cost.

Foreign exchange translation

The Company translates the assets, liabilities, income and expenses of its United States branch and its United States subsidiary, both of which are self-sustaining operations, to Canadian dollars on the following basis:

- Assets and liabilities are translated at the rate of exchange in effect at the balance sheet date.
- Income and expense items are translated at the rate in effect on the dates they occur.
- Gains and losses resulting from translation are deferred and shown as a separate component of retained earnings. The accumulated after tax loss deferred is $37,730,000 (2005 – $37,306,000).

Income taxes

Future income taxes result from temporary differences in the tax basis of an asset or liability and its carrying amount in the balance sheet. The future income tax asset/liability is computed at the tax rates that are expected to apply when the income tax asset or liability is settled.

Employee future benefits

The Company maintains defined benefit plans for substantially all employees. The plans provide pensions based on length of service and final average earnings. In addition, the Company provides life insurance, dental and health benefit plans for retired employees.

The costs of these benefits related to current service are charged to operations in the period in which the services are rendered. The actuarial determination of the accrued benefit obligations uses the projected benefit method prorated on service (which incorporates management's best estimate of future salary levels, future cost escalation, retirement ages of employees and other actuarial factors). Past service costs, any net excess actuarial gains or losses over 10% of the greater of the accrued benefit obligation and the market value of the plans assets, together with the transitional assets that resulted on the adoption of the new accounting standards, are amortized over the expected average remaining service lives of the employee group.

The excess of funding pension payments over pension expense is recorded as an asset. Non-pension benefits are not funded. The accumulated non-pension benefit expense is recorded as a liability.

The Company also provides defined contribution plans for certain employees. Contributions are expensed in the period that they are paid.

Unpaid claims

The provision for unpaid claims is established by the case method as claims are reported. The estimates are regularly reviewed and updated as additional information on the estimated unpaid claims becomes known and any resulting adjustments are included in the statement of operations and retained earnings. A provision is also made for management's calculation of factors affecting future development of unpaid claims including claims incurred but not reported (IBNR) based on the volume of business currently in force and the historical experience on claims. The unpaid claims are discounted as mandated by the Superintendent.

Salvage and subrogation

Salvage and subrogation recoveries on claims are recorded as a reduction of claims incurred on an accrual basis.

3 INVESTMENTS

	2006			2005		
	Cost	**Market value**	**Unrealized gains (losses)**	Cost	Market value	Unrealized gains (losses)
			('000s)			
Bonds						
Canadian						
Maturing in						
Less than one year	**$ 105,557**	**$ 105,425**	**$ (132)**	$ 5,811	$ 5,836	$ 25
One to five years	**488,172**	**488,407**	**235**	618,209	620,669	2,460
More than five years	**1,058,055**	**1,078,833**	**20,778**	974,435	1,012,588	38,153
	1,651,784	**1,672,665**	**20,881**	1,598,455	1,639,093	40,638
American						
Maturing in						
Less than one year	**13,607**	**13,556**	**(51)**	20,840	20,688	(152)
One to five years	**153,905**	**154,955**	**1,050**	127,780	127,310	(470)
More than five years	**551,654**	**549,639**	**(2,015)**	429,349	426,699	(2,650)
	719,166	**718,150**	**(1,016)**	577,969	574,697	(3,272)
	2,370,950	**2,390,815**	**19,865**	2,176,424	2,213,790	37,366
Stocks						
Preferred						
Canadian	**41,446**	**44,591**	**3,145**	41,977	45,132	3,155
Common						
Canadian	**396,218**	**682,965**	**286,747**	267,100	499,043	231,943
Foreign	**602,160**	**723,006**	**120,846**	525,002	571,462	46,460
	1,039,824	**1,450,562**	**410,738**	834,079	1,115,637	281,558
Total investments	**$ 3,410,774**	**$ 3,841,377**	**$ 430,603**	$ 3,010,503	$ 3,329,427	$ 318,924

Management has determined that a number of stocks with market values substantially below cost should be considered to be other than temporarily impaired. Those stocks have been written down to market value, with the write down totalling $214,000 (2005 – $2,511,000).

Management has reviewed currently available information regarding these investments whose market value is less than carrying value, and has determined that the carrying values are expected to be recovered. The carrying value of these investments is $1,246,355,000 and the market value is $1,228,538,000.

The total bond portfolio is subject to the credit risk that the issuers fail to honour the payment terms. This risk is minimized by exercising a policy of investing mainly in high quality government and corporate bonds and limiting the exposure to any one issuer.

Investment income is reported net of expenses of $5,523,000 (2005 – $5,049,000) and depreciation on real estate of $1,814,000 (2005 – $1,921,000).

Investment income includes the following:

	2006	2005
	('000s)	
Interest and dividends—net	$ 139,769	$ 118,252
Net gain on disposal of investments	60,174	79,024
Provision for write down of investments	(214)	(2,511)
	$ 199,729	$ 194,765

4 INVESTMENT IN SUBSIDIARY

	2006	2005
	('000s)	
The Wawanesa Life Insurance Company, 100% owned	$ 43,939	$ 41,509

A summary of the significant balance sheet items for The Wawanesa Life Insurance Company is as follows:

	2006	2005
	('000s)	
Bonds carried at amortized cost	$ 342,422	$ 326,880
Stocks carried at moving average market value	50,848	46,703
Mortgages	29,053	25,070
Accrued investment income	3,858	3,587
Other assets	20,482	16,186
	$ 446,663	$ 418,426
Policy liabilities	$ 350,255	$ 328,659
Other liabilities	20,205	19,387
Participating policyholders' accounts	26,543	23,150
Shareholder's equity	49,660	47,230
	$ 446,663	$ 418,426

A summary of the significant operating results for The Wawanesa Life Insurance Company is as follows:

	2006	2005
	('000s)	
Premium income	**$ 80,721**	$ 78,231
Investment income	**26,459**	24,581
	107,180	102,812
Benefits and expenses	**98,928**	92,259
Income before income taxes	**8,252**	10,553
Income taxes	**2,429**	3,473
Net income for the year	**$ 5,823**	$ 7,080

5 UNPAID CLAIMS

Management believes that the unpaid claims provision is appropriately established in the aggregate and is adequate to cover the ultimate net cost on a discounted basis. The determination of this provision, which includes unpaid claims, adjustment expenses, expected salvage and subrogation and the related reinsurers' share of each, requires an assessment of future claims development. This assessment takes into account the consistency of the Company's claim handling procedures, the amount of information available, the characteristics of the line of business from which the claims arise and the delay inherent in claims reporting. This provision is an estimate and as such is subject to variability that may arise from future events, such as the receipt of additional claims information, changes in judicial interpretation of contracts or significant changes in frequency and severity of claims. This estimate is principally based on the Company's historical experience and may be revised as additional experience becomes available. Any such changes would be reflected in the statement of income for the period in which the change occurred. This estimate does reflect the time value of money as mandated by the Superintendent. In that respect, the Company determines the discount rate based upon the expected return of bonds held in the portfolio that approximates the cash flow requirements of the unpaid claim. The discount rate applied was 4.75% (2005 – 4.75%). To recognize the uncertainty inherent in determining unpaid claim amounts, the Company includes a Provision for Adverse Deviations (PFADs) relating to claim development, reinsurance recoveries and future investment income. The PFADs selected are all within the ranges recommended by the Canadian Institute of Actuaries.

The table below details the provision for unpaid claims by major line of business:

	2006	2005
	('000s)	
Line of business		
Automobile	**$ 1,220,208**	$ 1,114,284
Personal property	**190,440**	166,410
Commercial property	**75,435**	77,646
Other	**34,865**	36,297
Total gross unpaid claims	**1,520,948**	1,394,637
Reinsurers' portion	**3,220**	25,081
Net unpaid claims	**$ 1,517,728**	$ 1,369,556

6 EMPLOYEE FUTURE BENEFITS

Description of benefit plans

The Company has a number of defined benefit and defined contribution plans providing pension and other retirement benefits to most of its employees. Pension benefits are based on length of service and final average earnings and may be indexed at the discretion of the Board of Directors. Other retirement benefit plans are non-contributory health care and life insurance plans.

Total cash payments

Total cash payments for employee future benefits for 2006, consisting of cash contributed by the Company to its funded pension plans, cash payments directly to beneficiaries for unfunded other benefit plans, and cash contributed to defined contribution plans, was $11,001,000 (2005 – $9,410,000).

Defined benefit plans

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation of the defined benefit pension plan for funding purposes was as of December 31, 2003 and December 31, 2004 for the supplemental plan. The next required valuation of the pension plans will be as of December 31, 2006.

Defined benefit plan assets

The percentage of plan assets by major category measured at December 31 is:

	2006	2005
	%	
Equity securities	**63**	54
Debt securities	**34**	38
Other	**3**	8
	100	100

Reconciliation of the funded status of the benefit plans to the amounts recorded in the financial statements

	Pension benefit plans		Other benefit plans	
	2006	2005	2006	2005
	('000s)			
Market value of plan assets	**$ 274,827**	$ 239,978	**$ -**	$ -
Accrued benefit obligation	**(256,816)**	(241,362)	**(32,445)**	(29,922)
Funded status of plans—surplus (deficit)	**18,011**	(1,384)	**(32,445)**	(29,922)
Balance of unamortized (gains) losses	**(7,307)**	11,331	**10,845**	11,350
Accrued benefit asset (liability)	**$ 10,704**	$ 9,947	**$ (21,600)**	$ (18,572)

The accrued benefit asset (liability) is included in the Company's balance sheet as follows:

	Pension benefit plans		Other benefit plans	
	2006	2005	2006	2005
	('000s)			
Receivables	$ **10,704**	$ 9,947	$ **-**	$ -
Other liabilities	**-**	-	**(21,600)**	(18,572)
	$ **10,704**	$ 9,947	$ **(21,600)**	$ (18,572)

Plans with accrued benefit obligations in excess of plan assets

Included in the above accrued benefit obligation and fair value of plan assets at year end are the following amounts in respect of plans that are not fully funded:

	Pension benefit plans		Other benefit plans	
	2006	2005	2006	2005
	('000s)			
Accrued benefit obligation	$ **(20,672)**	$ (25,927)	$ **(32,445)**	$ (29,922)
Fair value of plan assets	**18,113**	20,207	**-**	-
Funded status—plan deficit	$ **(2,559)**	$ (5,720)	$ **(32,445)**	$ (29,922)

Significant assumptions

The significant weighted average assumptions used in measuring the Company's pension and other obligations as at December 31 are:

	Pension benefit plans		Other benefit plans	
	2006	2005	2006	2005
Accrued benefit obligation:				
Discount rate	**4.75%**	4.75%	**5.25%**	5.25%
Rate of compensation increase	**4.75%**	4.75%	**-**	-
Benefit costs:				
Discount rate	**4.75%**	5.25%	**5.25%**	6.25%
Expected long-term rate of return on plan assets	**4.75%**	5.25%	**-**	-
Rate of compensation increase	**4.75%**	5.07%	**-**	-
Assumed health care cost trend rates*	**-**	-	**9.00%**	10.00%

*The health care cost trend rate will decline by 1% per year to the ultimate rate of 5% in 2010.

Benefits paid

Benefits paid were as follows:

	2006	2005
	('000s)	
Plans providing pension benefits	**$ 5,899**	$ 5,863
Plans providing other benefits	**484**	487
	$ 6,383	$ 6,350

Employee future benefit costs recognized in the year

The total cost recognized for the Company's defined benefit plans is as follows:

	2006	2005
	('000s)	
Plans providing pension benefits	**$ 8,897**	$ 5,645
Plans providing other benefits	**3,592**	2,674
	$ 12,489	$ 8,319

Defined contribution plans

The total cost recognized for the Company's defined contribution plans is as follows:

	2006	2005
	('000s)	
Plans providing pension benefits	**$ 413**	$ 442

7 INCOME TAXES

The provision for income taxes reflects an effective tax rate that differs from the combined tax rate for Canadian federal and provincial corporate taxes for the following:

	2006	2005
	('000s)	
Earnings before income taxes	**$ 257,801**	$ 218,000
Combined statutory tax rate	**34.60%**	35.29%
Tax payable based on statutory tax rate	**89,199**	76,932
Effect of:		
Permanent differences	**(5,993)**	(5,805)
Future income tax rate changes	**7,875**	(230)
Provision for uncertain tax filing positions	**10,335**	-
Realization of future tax asset previously not recorded	**(10,612)**	-
Capital taxes	**137**	132
Other	**2,190**	4,150
	$ 93,131	$ 75,179
Provision for income taxes		
Current	**$ 126,172**	$ 105,922
Future	**(33,041)**	(30,743)
	$ 93,131	$ 75,179

Prior to 2006, the tax effect of accumulated timing differences within the Company's US subsidiary was not recognized as a future tax asset. The Company has now determined that it is more likely than not that these timing differences will be utilized in future years. As such, a future tax asset of $10,612,000 has been recognized with a corresponding reduction in tax expense in the current year.

In January 2007, the Company became aware that foreign tax credits taken in prior years exceeded entitlement. An adjustment has been recorded as tax expense in the current year and is reflected in the provision for uncertain tax filing positions.

Future income tax assets and liabilities consist of temporary differences between the accounting and tax basis of assets and liabilities as follows:

	2006	2005
	('000s)	
Future income tax assets		
Invested assets	**$ 97,844**	$ 76,968
Policy liabilities	**35,947**	22,974
Employee future benefits	**3,661**	3,074
Other assets	**4,734**	5,809
	$ 142,186	$ 108,825

The Company expects that future income assets will be realized in the normal course of operations.

8 MORTGAGE PAYABLE

The mortgage payable to Standard Life Assurance Company is due December 1, 2008, payable in monthly instalments of $87,887 including interest at 6.75% and is secured by land and building, an assignment of leases and chattels therein. Payments due are as follows:

2007	**$**	**1,054,644**
2008		**13,781,108**

The mortgage was assumed as part of the vendor's terms in the acquisition of an office building in Winnipeg.

9 REINSURANCE

The Company has obtained reinsurance to limit its liability as follows:

- In the event of a series of claims arising out of a single occurrence the Company has obtained reinsurance having an upper amount of $450,000,000, which limits its liability to $36,375,000 in the event of a series of claims arising out of a single occurrence.
- Aggregate protection up to $25,000,000 after satisfaction of a $35,000,000 deductible. This deductible is based on an accumulation of all losses subject to the treaty that exceed $2,500,000 and are less than $22,500,000.

	2006	2005
	('000s)	
Net premiums ceded on an earned basis	**$ 36,163**	$ 31,675
Net claims and adjustment expenses ceded	**3,066**	37,516

10 CONTINGENT LIABILITIES

The Company has settled some claims by purchasing annuities (structured settlements) from life insurers. The Company guarantees the future annuity payments and thus is exposed to a credit risk to the extent any of the life insurers fail to fulfill their obligations. The risk is managed by acquiring annuities from several Canadian life insurers with proven financial stability. To December 31, 2006, no information has come to the Company's attention to suggest any financial weakness in life insurers from which it has purchased annuities. Consequently, no provision for credit risk is required. The credit risk exposure is estimated at the original purchase price of the annuities of $68,126,000 (2005 – $66,419,000).

11 RELATED PARTY TRANSACTIONS

The Company has the following transactions with The Wawanesa Life Insurance Company:

The Wawanesa Life Insurance Company

- The Company recovers the cost of expenses paid on behalf of or shared with the subsidiary totalling $10,412,000 (2005 – $9,434,000).
- The Company pays commissions on behalf of its brokers to investment accounts maintained by the subsidiary of $8,399,000 (2005 – $8,055,000).
- The Company purchases group employee benefits from the subsidiary at a cost of $3,674,000 (2005 – $3,663,000).

Balances between the Company and its subsidiary are settled on a regular basis and the outstanding amount is immaterial at December 31, 2006.

12 PREMIUM RATE REGULATION

Substantially all of the Company's automobile business and its United States property business are subject to rate regulation by various provincial and state regulators. This business comprises approximately 69% (2005 – 70%) of net premiums written.

Regulation of premium rates is based on the cost of providing insurance coverage which recognizes claims and other costs including anticipated profit margins. Insurance premiums can be subject to mandatory rate rollbacks and mandatory rate assessments imposed by provincial or state legislation or regulation. This could result in lower future premium rates or reductions to premium rates charged by the Company in prior periods. In addition, the Company is required, under the legislation of certain jurisdictions, to participate in risk sharing pools which may impact positively or negatively upon underwriting results. The impact of the participation is immaterial to the overall financial statements.

At various points throughout the year the Company will have applications pending with certain regulators for automobile premium rate changes. All are in the normal course of business. The Company is not aware of any proposed or pending rate rollbacks related to prior years.

13 COMPARATIVE FIGURES

Certain of the prior year's figures have been restated for comparative purposes.

AUDITORS' REPORT

Incorporated July 7, 1960

Head Office
Wawanesa, Manitoba

Executive Office
200–191 Broadway
Winnipeg, Manitoba

OFFICERS AND MANAGEMENT

Corporate

G. J. Hanson, FCA, FCIP, FLMI
President and Chief Executive Officer

M. K. Nemeth, CA, FLMI, GBA
Vice President and Chief Operating Officer

G. N. Bass, Q.C.
Vice President, General Counsel and Secretary

I. R. MacDonald, FSA, FCIA
Vice President and Actuary

C. R. Loeppky, BScCs
Vice President, Information Services

T. L. Nelson, FLMI/M, CHRP
Vice President, Human Resources

W. D. Evans
Manager, Residential Mortgages

P. M. Horncastle, CGA
Comptroller

P. R. Mulaire, CMA, FCIP, CIA
Manager, Internal Audit

K. J. Richtik, ASA
Manager, Actuarial Financial Reporting

Insurance Operations

G. G. Sadler, CLU, ChFC, RHU
Director, Individual Sales and Marketing

R. A. Maharajh, CMA, FSA, FCIA
Group Actuary

M. M. Nolin, ALHC
Manager, Group Claims

M. Smith, FLMI, CFP, CLU, ChFC
Manager, Advanced Marketing

D. M. Smook
Manager, National Group Sales & Service

A. E. Waller, MBA, CFP, ChFC, CLU
Manager, Individual Life Administration

Medical Director

Dr. R. B. Boyd, MD

To the Policyholders and Shareholder of The Wawanesa Life Insurance Company

We have audited the balance sheet of **The Wawanesa Life Insurance Company** as at December 31, 2006 and the statements of operations, participating policyholders' account, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
February 19, 2007, Winnipeg, Manitoba

PRICEWATERHOUSECOOPERS

To the Policyholders and Shareholder of The Wawanesa Life Insurance Company

I have valued the policy liabilities of **The Wawanesa Life Insurance Company** for its balance sheet at December 31, 2006 and their change in the statement of operations for the year then ended in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of policy liabilities makes appropriate provision for all policyholder obligations and the financial statements fairly present the result of the valuation.

Ian R. MacDonald

Ian R. MacDonald
Fellow, Canadian Institute of Actuaries
February 19, 2007, Winnipeg, Manitoba

BRANCH OFFICES

Atlantic
1010 St. George Boulevard
Moncton, New Brunswick
J. C. Best
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R. W. Bridle
Individual Life Manager
E. T. Tollefsen
Group Manager

Manitoba
700–200 Main Street
Winnipeg, Manitoba
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Individual Life Manager
T. McDowell
Group Manager

Saskatchewan
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Regina, Saskatchewan
L. P. J. Addison
Individual Life Manager

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Edmonton, Alberta
C. E. Laing
Individual Life Manager

Calgary
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Calgary, Alberta
R. E. Derdall
Individual Life Manager
R. N. Lastwika
Group Manager

British Columbia
310–1985 West Broadway
Vancouver, British Columbia
B. L. Russell
Individual Life Manager
T. C. Hickmore
Group Manager
B. R. Wyne
Group Manager

BALANCE SHEET

	As at December 31	
	2006	2005
	('000s)	
ASSETS		
Investments (note 3)	$ 435,382	$ 410,845
Cash	1,780	897
Outstanding premiums	930	517
Investment income due and accrued	3,858	3,587
Income taxes recoverable	1,191	-
Other assets	3,522	2,580
General Fund Assets	$ 446,663	$ 418,426
Segregated Funds (note 7)	$ 129,104	$ 106,717
LIABILITIES		
Policy liabilities (note 4)	$ 350,255	$ 328,659
Other liabilities	2,134	1,745
Income taxes payable	-	814
Future income taxes (note 6)	1,893	810
Deferred gains on disposal of portfolio investments (note 3)	16,178	16,018
	370,460	348,046
POLICYHOLDERS' AND SHAREHOLDER'S EQUITY		
Participating policyholders' account	26,543	23,150
Shareholder's equity		
Share capital (note 8)	11,500	11,500
Retained earnings	38,160	35,730
	49,660	47,230
	76,203	70,380
General Fund Liabilities and Equity	$ 446,663	$ 418,426
Segregated Funds	$ 129,104	$ 106,717

The accompanying notes constitute an integral part of the consolidated financial statements.

STATEMENT OF OPERATIONS

	For the year ended December 31	
	2006	2005
	('000s)	
Income		
Premiums		
Life insurance	**$ 34,725**	$ 33,308
Health insurance	**20,179**	19,703
Annuities	**25,817**	25,220
	80,721	78,231
Net investment income (note 3)	**26,459**	24,581
	107,180	102,812
Benefits and expenses		
Amounts paid or credited to policyholders and their beneficiaries		
Death, disability and health benefits	**23,831**	24,980
Annuity payments	**4,000**	4,036
Maturities and surrenders	**26,342**	26,631
Dividends and interest	**4,305**	4,104
Increase in actuarial liabilities	**20,227**	13,901
	78,705	73,652
Commissions	**7,277**	6,851
Operating expenses	**11,333**	10,194
Taxes and licences	**1,613**	1,562
	98,928	92,259
Income before income taxes	**8,252**	10,553
Income taxes (note 6)		
Current	**1,346**	2,497
Future	**1,083**	976
	2,429	3,473
Net income for the year	**$ 5,823**	$ 7,080
Allocated to		
Participating policyholders' account	**$ 3,481**	$ 2,368
Shareholder	**2,342**	4,712
	$ 5,823	$ 7,080

The accompanying notes constitute an integral part of the consolidated financial statements.

STATEMENT OF PARTICIPATING POLICYHOLDERS' ACCOUNT

	For the year ended December 31			
	2006		2005	
	('000s)			
Balance—Beginning of year	**$**	**23,150**	$	20,866
Share of net income for the year		**3,481**		2,368
Transfer to non-participating account (note 9)		**(88)**		(84)
Balance—End of year	**$**	**26,543**	$	23,150

STATEMENT OF RETAINED EARNINGS

	For the year ended December 31			
	2006		2005	
	('000s)			
Balance—Beginning of year	**$**	**35,730**	$	30,934
Share of net income for the year		**2,342**		4,712
Transfer from participating account (note 9)		**88**		84
Balance—End of year	**$**	**38,160**	$	35,730

The accompanying notes constitute an integral part of the consolidated financial statements.

STATEMENT OF CASH FLOWS

	For the year ended December 31	
	2006	2005
	('000s)	
CASH PROVIDED BY (USED IN)		
Operating activities		
Receipts		
Premium and annuity considerations	**$ 78,174**	$ 76,459
Investment income received	**20,335**	22,844
Other revenue	**2,134**	1,778
	100,643	101,081
Payments		
Benefits and annuity payments	**46,689**	47,291
Net transfers to segregated funds	**6,172**	8,635
Insurance expenses and taxes	**23,186**	20,161
Dividends to policyholders	**4,305**	4,104
Change in other assets and liabilities	**885**	452
	81,237	80,643
Cash provided by operating activities	**19,406**	20,438
Investing activities		
Purchases, bonds and stocks	**(256,974)**	(333,048)
Disposals, bonds and stocks	**243,301**	311,149
Advances, mortgage and policy loans	**(12,707)**	(10,773)
Repayments, mortgage and policy loans	**7,857**	11,832
Cash used in investing activities	**(18,523)**	(20,840)
Net increase (decrease) in cash for the year	**883**	(402)
Cash—Beginning of year	**897**	1,299
Cash—End of year	**$ 1,780**	$ 897
Income taxes paid	**$ 3,351**	$ 1,449

The accompanying notes constitute an integral part of the financial statements.

1 REPORTING RESPONSIBILITIES

The financial statements and accompanying notes are the responsibility of management.

The external auditors of the Company are required to conduct an examination in accordance with Canadian generally accepted auditing standards to enable their reporting to the policyholders and the shareholder as to whether the annual financial statements present fairly, in all material respects, the financial position and results of operations of the Company in accordance with Canadian generally accepted accounting principles.

The Appointed Actuary is appointed by the Board of Directors of the Company and:

- is responsible for ensuring that the assumptions and methods used in the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation and associated regulations or directives;
- is required to provide an opinion regarding the appropriateness of the policy liabilities at the balance sheet date to meet all policyholder obligations of the Company. Examination of supporting data for accuracy and completeness and analysis of Company assets for their ability to support the amount of policy liabilities are important elements of the work required to form this opinion;
- is required each year to analyze the financial condition of the Company and prepare a report for the Board of Directors. The analysis tests the capital adequacy of the Company until December 31, 2010 under adverse economic and business conditions.

2 SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with the Insurance Companies Act which states that, except as otherwise specified by the Office of the Superintendent of Financial Institutions Canada (OSFI or the Superintendent), the financial statements are to be prepared in accordance with Canadian generally accepted accounting principles (GAAP). The significant accounting policies used in the preparation of these financial statements, including the accounting requirements of the Superintendent, are summarized below. These accounting policies conform, in all material respects, to Canadian generally accepted accounting principles.

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenue and expenses during the periods covered by the financial statements. The principal financial statement components subject to measurement uncertainty include the provision for policy liabilities (note 4) and the carrying value of future tax liabilities (note 6). Actual results could differ from those estimates.

Portfolio investments

Bonds are carried at amortized cost. Realized gains and losses on the disposal of bonds are considered to be an adjustment of future portfolio yield and are deferred and amortized to income over the remaining term to maturity of the security sold.

Stocks are carried at moving average market value whereby the carrying value is adjusted towards market value on a quarterly basis at the rate of 5% per quarter applied to differences between market values and the previous quarter-end carrying values. Realized gains and losses on the disposal of stocks are deferred and amortized to income at the rate of 5% per quarter.

Mortgages are carried at their outstanding principal balances.

Impairment of bonds and mortgages is assessed on an individual basis. Provisions are established where, in the opinion of management, there is an other than temporary impairment in value.

Loans to policyholders are carried at their outstanding balances and are fully secured by the cash surrender values of the policies.

Premium income and benefits and expenses

Gross premiums for all types of insurance contracts, and contracts with limited mortality or morbidity risk, are generally recognized as revenue when due. When premiums are recognized, actuarial liabilities are computed, with the result that benefits and expenses are matched with such revenue.

Income taxes

Future income taxes result from temporary differences in the tax basis of an asset or liability and its carrying amount in the balance sheet. The future income tax asset/liability is computed at the tax rates that are expected to apply when the income tax asset or liability is settled.

Pension and post employment benefits

Employees of the Company are provided with pension and post employment benefits on a defined benefit basis through membership in plans offered by The Wawanesa Mutual Insurance Company. The Wawanesa Mutual Insurance Company owns 100% of the issued and outstanding shares of the Company. The obligation for funding of these plans rests with The Wawanesa Mutual Insurance Company. The Company is charged appropriate annual service costs for all benefits and remits these amounts to The Wawanesa Mutual Insurance Company.

3 INVESTMENTS

The carrying value and fair values of portfolio investments are as follows:

	2006		2005	
	Carrying value	Fair value	Carrying value	Fair value
	('000s)			
Bonds	**$ 342,422**	**$ 359,162**	$ 326,880	$ 347,910
Stocks	**50,848**	**69,607**	46,703	60,396
Mortgages	**29,053**	**28,846**	25,070	24,966
Policy loans	**13,059**	**13,059**	12,192	12,192
	$ 435,382	**$ 470,674**	$ 410,845	$ 445,464

The balance of net deferred realized gains is comprised of the following:

	2006	2005
	('000s)	
Bonds	**$ 12,474**	$ 12,435
Stocks	**3,704**	3,583
	$ 16,178	$ 16,018

Investment income is from the following sources:

	2006	2005
	('000s)	
Bonds	**$ 18,966**	$ 18,312
Stocks	**5,550**	4,342
Mortgages	**1,411**	1,472
Policy loans	**875**	816
Other	**206**	134
Expenses	**(549)**	(495)
	$ 26,459	$ 24,581

Included in investment income is the amortization of net deferred realized gains for all portfolio investments and of net unrealized gains on stocks as follows:

	2006		2005	
	('000s)			
Bonds	**$**	**2,534**	$	2,677
Stocks		**4,151**		3,165
	$	**6,685**	$	5,842

Terms and conditions

Details of significant terms and exposure to interest rate risk on investments are as follows:

Bonds are comprised of government 45.3% (2005 – 48.8%) and corporate 54.7% (2005 – 51.2%) with effective interest rates of 3.0% to 9.5% (2005 – 2.7% to 9.5%). Maturities range from less than one year to 37 years. Bonds with a quality rating of BBB or higher represent 100% (2005 – 100%) of the portfolio. Bonds rated A or higher constitute 97.6% (2005 – 95.4%) of the portfolio.

Stocks are comprised of units in institutional pooled equity funds. These funds include investments in common stock of major Canadian, U.S. and International companies and in Canadian corporate and government bonds. In general, stocks have no fixed maturity date and are not exposed directly to interest rate risk. Dividend yields on these funds range from 1.8% to 2.7% (2005 – 1.8% to 2.5%).

Mortgages are secured by first recourse on residential properties. Interest rates range from 3.8% to 7.5% (2005 – 3.5% to 8.25%). Virtually all are for a fixed term ranging from 6 months to 10 years (2005 – 6 months to 10 years) and 46.6% (2005 – 47.1%) of balances are insured. Principal and interest payments are received on a monthly or more frequent basis.

Policy loans have interest rates which are set annually and range from 6% to 7% (2005 – 6% to 7%).

Concentration

The Company limits its investment concentration in any one corporate investee or control group to 3% of assets.

Asset impairment

General provisions made for anticipated future losses of principal and interest on investments are included as a component of policy liabilities and are approximately $4,219,000 (2005 – $3,829,000).

Derivative financial instruments

The Company does not invest in derivative financial instruments.

4 POLICY LIABILITIES

Nature of policy liabilities

Policy liabilities represent an estimate of the amount which, together with future premiums and investment income, will be sufficient to pay outstanding claims and provide for future benefits, dividends and expenses under all in-force insurance and annuity contracts. Policy liabilities consist of the following:

	2006		2005	
	('000s)			
Actuarial liabilities	**$**	**338,383**	$	318,156
Provision for unpaid and unreported claims		**6,448**		5,136
Policyholder amounts on deposit		**5,424**		5,367
Total policy liabilities	**$**	**350,255**	$	328,659

Actuarial liabilities

Actuarial liabilities are comprised of the following amounts for each significant line of business:

	2006	2005
	('000s)	
Individual life participating	**$ 131,159**	$ 120,407
Individual life non-participating	**56,702**	48,850
Individual annuities participating	**49,255**	51,212
Individual annuities non-participating	**84,380**	82,723
Group life and health	**16,887**	14,964
Total actuarial liabilities	**$ 338,383**	$ 318,156

Actuarial liabilities have been determined by the Appointed Actuary using accepted actuarial practice which involves the use of assumptions for such factors as mortality and morbidity rates, future investment yields, future expense levels and rates of withdrawal. The process of determining actuarial liabilities necessarily involves the risk that actual results will deviate from assumed results. The risk varies in proportion to the length of the period covered by each assumption and the potential volatility of actual results.

Each assumption is determined based on expected experience plus a margin. The margin provides for uncertainty in establishing expected experience and to allow for possible deterioration in experience. The additional reserve resulting from using assumptions which include these margins is referred to as the provision for adverse deviations. The provision will be included in future income to the extent it is not required to cover adverse experience.

The nature and method of determining the significant assumptions made in the computation of actuarial liabilities are described below.

Mortality and morbidity rates—Estimates of future mortality and morbidity rates are based on the Company's and industry experience over extended periods.

Investment yields—Assumptions regarding future investment yields are based on current yield rates, adjusted to reflect uncertainties associated with projections of future interest rates.

Expense levels—Future expense assumptions are based on the Company's past experience and projections for the future.

Rates of withdrawal—Policyholders may lapse their policies by discontinuing premium payments or surrendering their policies for the cash surrender value. Estimates of future rates of withdrawal are based on previous Company experience augmented by industry experience.

Assets supporting actuarial liabilities

	2006				
	Bonds	Mortgage loans	Stocks	Other	Total
	('000s)				
Balance sheet value					
Participating					
Individual life	**$ 91,152**	**$ -**	**$ 25,556**	**$ 14,451**	**$ 131,159**
Individual annuity	**36,851**	**11,988**	**-**	**416**	**49,255**
Non-participating					
Individual life	**54,764**	**-**	**-**	**1,938**	**56,702**
Individual annuity	**66,275**	**17,065**	**-**	**1,040**	**84,380**
Group Life and Health	**16,874**	**-**	**-**	**13**	**16,887**
Other, including capital and surplus	**76,506**	**-**	**25,292**	**6,482**	**108,280**
Total balance sheet value	**$ 342,422**	**$ 29,053**	**$ 50,848**	**$ 24,340**	**$ 446,663**
Fair value	**$ 359,162**	**$ 28,846**	**$ 69,607**	**$ 24,340**	**$ 481,955**

	2005				
	Bonds	Mortgage loans	Stocks	Other	Total
	('000s)				
Balance sheet value					
Participating					
Individual life	$ 84,258	$ -	$ 23,416	$ 12,733	$ 120,407
Individual annuity	40,320	10,814	-	78	51,212
Non-participating					
Individual life	46,499	-	-	2,351	48,850
Individual annuity	67,879	14,256	-	588	82,723
Group Life and Health	14,787	-	-	177	14,964
Other, including capital and surplus	73,137	-	23,287	3,846	100,270
Total balance sheet value	$ 326,880	$ 25,070	$ 46,703	$ 19,773	$ 418,426
Fair value	$ 347,910	$ 24,966	$ 60,396	$ 19,773	$ 453,045

Cash flows of assets supporting actuarial liabilities are matched within reasonable limits. Changes in the fair values of assets are essentially offset by changes in the fair value of actuarial liabilities.

The carrying value of assets backing actuarial liabilities plus the portion of deferred gains associated with actuarial liabilities is $349,005,000 (2005 – $328,781,000). The fair value of these assets is $369,342,000 (2005 – $349,978,000). Based on the projected cash flows of the Company as of December 31, 2006, the approximate after tax impact of an immediate 1% increase in the general level of interest rates applied to actuarial liabilities and associated assets would be to increase the fair value of surplus by $6,472,000 (2005 – $5,396,000). The impact of an immediate 1% decrease would decrease the fair value of surplus by $7,415,000 (2005 – $6,151,000).

Change in actuarial liabilities

The change in actuarial liabilities is as follows:

	2006	2005
	('000s)	
Balance—beginning of year	**$ 318,156**	$ 304,255
Normal change		
New business	**2,993**	4,251
In force	**18,185**	12,198
Change in method and assumptions	**(951)**	(2,548)
Balance—end of year	**$ 338,383**	$ 318,156

Valuation assumptions are reviewed and updated annually. Changes in assumptions can increase or decrease actuarial liabilities. The 2006 assumption changes reduced actuarial liabilities by $951,000. The two most significant changes were related to expenses and lapse experience. Expense assumption changes reduced actuarial liabilities by $1,763,000 and lapse assumption changes increased reserves by $790,000. The 2005 assumption changes reduced actuarial liabilities by $2,548,000. The most significant change reduced actuarial liabilities by $2,210,000 in recognition of improvement in individual life insurance mortality.

5 REINSURANCE CEDED

In the normal course of business, the Company limits the amount of loss on any one policy by reinsuring certain levels of risk in various areas of exposure with reinsurers.

Reinsurance ceded does not discharge the Company's liabilities as the primary insurer. Failure of reinsurers to honour their obligations could result in losses to the Company. A contingent liability exists should an assuming company be unable to meet its obligations.

The retention limits or maximum exposure on insurance policies are as follows:

	2006	2005
	('000s)	
Individual Life	**$ 200**	$ 200
Group Life	**150**	150
Group Health—out of country	**100**	100
Group Disability	**14/year**	14/year

The Company also has reinsurance in place for multiple deaths resulting from a catastrophic accident. Coverage is for up to $10,000,000 (2005 – $10,000,000) of claims from a single accident.

The figures shown in the financial statements are net of the following amounts related to reinsurance ceded:

	2006	2005
	('000s)	
Premiums	**$ 7,739**	$ 6,864
Claims	**6,096**	5,062
Actuarial liabilities	**39,367**	32,287

6 INCOME TAXES

The provision for income taxes reflects an effective tax rate that differs from the combined tax rate for Canadian federal and provincial corporate taxes for the following:

	2006		2005	
	('000s)			
Earnings before income taxes	$	**8,252**	$	10,553
Combined statutory tax rate		**35.80%**		36.40%
Tax payable based on statutory tax rate		**2,954**		3,842
Effect of:				
Permanent differences		**(251)**		(324)
Future income tax rate changes		**(212)**		(7)
Capital taxes		**(47)**		(26)
Other		**(15)**		(12)
	$	**2,429**	$	3,473
Provision for income taxes				
Current	$	**1,346**	$	2,497
Future		**1,083**		976
	$	**2,429**	$	3,473

Future income tax assets and liabilities consist of temporary differences between the accounting and tax basis of assets and liabilities as follows:

	2006		2005	
	('000s)			
Future income tax liabilities				
Invested assets	$	**2,340**	$	1,371
Policy liabilities		**774**		740
Deferred gains on portfolio investments		**(1,132)**		(1,227)
Other liabilities		**(89)**		(74)
	$	**1,893**	$	810

7 SEGREGATED FUNDS

The net asset value of the Segregated Funds, for which the Company is the issuer, totalled $129,104,000 (2005 – $106,717,000) at December 31, 2006. These Funds act as an investment vehicle for policyholders within individual savings plans. Segregated Fund policyholders bear the full investment risk of, and receive all the benefits from, the assets of the Funds. Investments held for Segregated Funds are carried at market value. Segregated Funds are presented separately in the Company's financial statements for information purposes and do not form part of the General Funds of the Company.

8 SHARE CAPITAL

Authorized—Unlimited number of common shares without par value

Issued and outstanding—11,500 common shares, all of which have been issued for cash to The Wawanesa Mutual Insurance Company

9 TRANSFER FROM PARTICIPATING ACCOUNT TO SHAREHOLDER

From time to time, the Board of Directors sets apart a portion of participating policyholders' equity as safe and proper for distribution as dividends or bonuses to participating policyholders. Of the amount set apart, the shareholder is entitled to a portion as permitted by governing statute.

The Company converted from mutual to stock form of ownership on October 1, 1993. The plan of conversion places restrictions on transfers from the participating account to the shareholder for 5 or 15 years from the date of conversion depending on the type of policy and date of issue. Effective October 1, 1998, amounts may be allocated to the shareholder related to participating life insurance policies issued on or after October 1, 1993 and all participating annuity policies.

The shareholder is entitled to 10% of the amounts set apart for these policies on an annual basis.

10 MINIMUM CAPITAL REQUIREMENTS

OSFI requires Canadian life insurance companies to maintain minimum levels of capital with respect to their insurance operations in order to provide additional assurance with respect to future solvency. These capital levels are calculated in accordance with the Minimum Continuing Capital and Surplus Requirements (MCCSR) issued by OSFI. The minimum capital ratio specified by OSFI is 120%. At the end of 2006 and 2005, the Company ratio was in excess of 200%.

11 RELATED PARTY TRANSACTIONS

The Company has the following transactions with its parent Company:

- The Company reimburses the cost of expenses paid on its behalf or shared with the parent totalling $10,412,000 (2005 – $9,434,000).
- The parent Company pays commissions on behalf of its brokers to investment accounts maintained by the Company of $8,399,000 (2005 – $8,055,000).
- The parent Company purchases group employee benefits from the Company at a cost of $3,674,000 (2005 – $3,663,000).

Balances between the Company and its parent are settled on a regular basis and the outstanding amount is immaterial at December 31, 2006.

12 SEGMENTED INFORMATION

2006	Individual life	Individual annuity	Group life and health	Capital and surplus	Total
	('000s)				
Premium income	**$ 30,995**	**$ 25,817**	**$ 23,909**	**$ -**	**$ 80,721**
Investment income	**13,511**	**5,887**	**1,084**	**5,977**	**26,459**
Income taxes	**(101)**	**1,163**	**(107)**	**1,474**	**2,429**
Net income	**832**	**1,081**	**(593)**	**4,503**	**5,823**

2005	Individual life	Individual annuity	Group life and health	Capital and surplus	Total
	('000s)				
Premium income	$ 29,158	$ 25,220	$ 23,853	$ -	$ 78,231
Investment income	12,067	5,959	1,229	5,326	24,581
Income taxes	(175)	954	1,249	1,445	3,473
Net income	523	590	2,086	3,881	7,080

13 COMPARATIVE FIGURES

Certain of the prior year's figures have been restated for comparative purposes.

RISK MANAGEMENT AND CONTROL PRACTICES

The Company has developed a series of management programs that address all material risks to which the Company is exposed. These Risk Management Programs have been approved by the Board of Directors. Each risk management program defines the particular risk, the basis on which the risk will be measured, sets limits on risk exposure and provides for reporting on actual exposure to the Board of Directors, a designated committee of the Board or senior management.

Mortality Risk

The Company is exposed to mortality risk through both individual and group policies. The insurability of applicants is determined in accordance with established and documented underwriting standards. Exposure to large claims is managed through the establishing of policy retention limits. Insurance amounts in excess of the retention limit on a single life are reinsured with other companies. The maximum retention for individual life insurance policies is $200,000 and the maximum retention for group life insurance policies is $150,000. The exposure to multiple claims from a single accidental cause is managed by a catastrophe reinsurance agreement. The catastrophe reinsurance covers aggregate claims in excess of $1,000,000 up to a maximum amount of $10,000,000. Claims experience (actual vs. expected) is monitored by management. This information is reported to the Board of Directors regularly.

Morbidity Risk

The Company is exposed to significant morbidity risk through the issuance of group long term disability and extended health coverages. The acceptance and rating of all health and disability applicants is determined in accordance with established and documented underwriting standards and procedures. Exposure to large claims is managed by establishing policy retention limits. Insurance amounts in excess of the retention limit on a single life are reinsured with other companies. The maximum retention for long-term disability is $1,200 of monthly benefit and for out-of-country extended health benefits is a $100,000 annual benefit. Morbidity claims experience is reported to the Board of Directors regularly. Senior management regularly reviews actual morbidity experience to industry studies. Claims management policies have been established and documented for all types of disability and health claims.

Lapse Risk

The termination (or lapse) of individual life insurance policies may expose the Company to risk. Policyholders may lapse their policies by discontinuing premium payments or requesting surrender of their policies for the cash value. When developing a new product or pricing an existing product, the Company carefully analyzes the amount of policy termination risk. Policy termination assumptions are based on Company experience augmented by industry experience. Reinsurance is used to lessen this risk for certain plans. Company policy termination experience is monitored by senior management on a quarterly basis.

Expense Risk

The Company is exposed to expense risk to the extent that future expense levels exceed those guaranteed to policyholders or assumed in the calculation of actuarial liabilities. Senior management reviews expense levels on a quarterly basis and approves expenditures of large amounts and the hiring of additional personnel.

Interest Rate Risk

The Company is exposed to interest rate risk in the normal course of business. The risk exists to the extent that cash flows from the assets supporting the liabilities do not match the policy obligations in timing and amount. The Company's exposure to future changes in interest rates is significantly reduced for many lines of business due to the practice of matching cash flows on the assets with those of the corresponding liabilities.

Investments are divided into four segments for purposes of investment policy related to interest rate risk. Guidelines limiting the interest rate risk to be assumed are set out by the Board of Directors in the Company's Investment Policy Statement. Techniques for measuring interest rate risk include duration analysis, cash flow analysis and yield curve sensitivity testing. The interest rate risk is monitored by management on a monthly or more frequent basis and is reported to the Investment Committee of the Board quarterly. The Company does not invest in derivative financial instruments.

Credit Risk

Credit guidelines have been established by the Board of Directors and are set out in the Company's Investment Policy Statement for both the bond and mortgage portfolios. Adherence to credit guidelines is monitored on a continuous basis by management and reported to the Investment Committee on a quarterly basis.

RISK MANAGEMENT AND CONTROL PRACTICES

At December 31, 2006, 100% of the bond portfolio was rated investment grade (BBB) or better with 97.6% rated 'A', 'AA', or 'AAA'. At December 31, 2006, the largest credit exposure to one corporate credit was 15.8% of Policyholders' and Shareholder's Equity.

The mortgage portfolio is comprised of single-family, owner-occupied dwellings in the Winnipeg, Manitoba area. At December 31, 2006, 46.6% of mortgage loans were insured with the Canada Mortgage and Housing Corporation. The largest single mortgage balance was $244,000. Mortgages with payments in arrears represented 1.1% of the portfolio.

The Company does not invest in commercial mortgages or loans.

Reinsurance Risk

The Company utilizes reinsurance primarily to limit the mortality or morbidity exposure to a single life. Additional amounts of mortality risk may also be reinsured where it is in the financial interest of the Company to do so. An insignificant amount of interest rate and lapse risk is reinsured. The majority (99%) of the reinsurance business is transacted with companies registered in Canada which are subject to regulation by the Office of the Superintendent of Financial Institutions Canada. All reinsurance arrangements are approved by senior management.

Liquidity Risk

The Company must maintain adequate liquidity to meet policyholder obligations as they come due. The primary obligations are annuity policy values and insurance claims and policy values.

Liquidity guidelines have been established by the Board of Directors and are set out in the Company's Investment Policy Statement. The guidelines require that the portion of the investment portfolio that is readily marketable equals or exceeds these policyholder obligations. This is monitored on a quarterly basis. Readily marketable assets include all bonds with an 'A' or better rating and all Canadian equities. At December 31, 2006, readily marketable assets represented 116.5% of all policy liabilities.

DIVIDEND POLICY STATEMENT

1. INTRODUCTION

This Dividend Policy Statement has been adopted by the Board of Directors and a copy has been sent to the Superintendent of Financial Institutions. All dividends declared must be in accordance with this Dividend Policy Statement.

Prior to approving a dividend scale, the Board of Directors will receive a report from the Company's appointed actuary stating whether, in his opinion, the dividend scale conforms to this Dividend Policy Statement and the professional practice standards of the Canadian Institute of Actuaries on dividend determination.

2. ELIGIBILITY TO RECEIVE DIVIDENDS

Participating Immediate Annuity Policies

Immediate annuity policies provide a periodic annuity payment for the life of the annuitant or for a specified time period. The amount of the annuity payment is comprised of a guaranteed portion and a dividend portion. No change in the dividend portion is anticipated.

Participating Deferred Annuity Policies

These policies are accumulation annuity products which carry a guaranteed minimum rate of return. At the time a deposit is received, a current rate of interest is applied for the specified investment period. The difference between the current rate and the guaranteed rate is the dividend component.

Participating Individual Life Insurance Policies

Dividends on these policies are anticipated to be paid annually, beginning as of the end of the second policy year. The amount available to be paid as dividends is determined based on various factors including the Company's earnings, any regulatory requirements and the amount of surplus required to ensure the continuing financial stability of the Company.

The dividend scale is designed to allocate dividends in a fair and equitable manner between the classes of policyholders. The dividend scale sets out a formula for the payment to policies of distributable earnings originating from three sources; investment earnings, mortality, and expense experience. The dividend scale is designed to distribute dividends among policies in the same proportion as the policies are considered to have contributed to distributable earnings.

The dividend scale for these policies will be updated when significant changes in experience occur.

SOURCE OF EARNINGS

The Source of Earnings are attributed to one of the following categories.

Expected Profit on In-force Business
This includes the release of the Provisions for Adverse Deviations (PFADs) plus the expected profits on Segregated Funds. The release of the PFADs is the profits arising on the in-force business if the expected assumptions used in calculating the actuarial liabilities are realized.

Impact of New Business
This represents the overall loss during the first year on new business. The PFADs in the actuarial liabilities contribute to an over-all initial loss on issuing new business. These PFADs are anticipated to be released into income in future years to the extent they are not required to cover future adverse experience.

Experience Gains and Losses
The experience gains result from items such as investment returns, claims and expenses where the actual experience during the year differs from the expected experience assumed in the actuarial liabilities. It also includes the amount the fee income generated on Segregated Funds differs from expected.

Management Action and Changes in Assumptions
This section includes specific management actions and the impact of changes in assumptions used to calculate actuarial liabilities.

Earnings on Surplus
This reflects the earnings on the surplus and capital of the Company.

Other
This represents all other sources of earnings not included above.

Source of Earnings in 2006

	Total Company	Individual Life	Individual Annuity	Group Life and Health
	('000s)			
Expected profit on in-force business	**$ 6,973**	**$ 3,524**	**$ 1,550**	**$ 1,899**
Impact of new business	**(7,760)**	**(6,215)**	**(133)**	**(1,412)**
Experience gains and losses	**3,200**	**3,138**	**779**	**(717)**
Management action and change in assumptions	**7**	**(40)**	**47**	**-**
Other	**(145)**	**324**	**-**	**(469)**
Earnings on operations	**2,275**	**731**	**2,243**	**(699)**
Earnings on surplus	**5,977**			
Income before income taxes	**8,252**			
Income taxes	**2,429**			
Net Income	**5,823**			

Source of Earnings in 2005

	Total Company	Individual Life	Individual Annuity	Group Life and Health
	('000s)			
Expected profit on in-force business	$ 6,146	$ 2,809	$ 1,427	$ 1,910
Impact of new business	(9,649)	(7,968)	(229)	(1,452)
Experience gains and losses	6,377	2,908	226	3,243
Management action and change in assumptions	2,548	2,409	119	20
Other	(195)	191	-	(386)
Earnings on operations	5,227	349	1,543	3,335
Earnings on surplus	5,326			
Income before income taxes	10,553			
Income taxes	3,473			
Net Income	7,080			

DIRECTORS

B.W. Harrison 1,2,3,4,5
Chairman of the Board

A.B. Ransom 1,3

G.J. Hanson 3,5

S.M. Van De Velde 2,3

D.M. Jessiman 4,5

M.E. Northey 1,2

D.G. Unruh 2,3

J.S. McCallum 3,4

R.R. Bracken 3,5

D.C. Crewson 1,4

1. Member of the Audit Committee
2. Member of the Conduct Review and Corporate Governance Committee
3. Member of the Investment Committee
4. Member of the Human Resources Committee
5. Member of the Donations Committee

Standing (L to R): D.C. Crewson, R.R. Bracken, D.M. Jessiman, S.M. Van De Velde, A.B. Ransom, J.S. McCallum, M.E. Northey, D.G. Unruh
Seated (L to R): G.J. Hanson, B.W. Harrison